ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	
Policy and Rules Concerning the Interstate, Interexchange Marketplace	CC Docket No. 96-61
Implementation of § 254(g) of the Communications Act of 1934, as amended	

REPLY COMMENTS OF AT&T CORP.

Market Definition, Separation, Rate Averaging and Rate Integration

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SUMMARY

Market Definition. The comments confirm that the Commission does not need to revise its longstanding definition of the interexchange market in order to evaluate future Bell Operating Company ("BOC") applications under Section 271. The BOC's market power over interexchange services is a product of their local bottleneck monopolies, which give them the unique ability to impede interexchange competition by leveraging their control over essential exchange and exchange access facilities to disadvantage unaffiliated interexchange carriers. The BOCs ignore the power of their bottlenecks, which the Commission has long recognized as an independent basis for special regulatory treatment. Accordingly, for purposes of assessing the market power of the BOCs in the context of future BOC applications under Section 271, the Commission should look not at the interexchange market, but rather at whether the BOC has lost its considerable power over the local market.

The comments virtually all agree that the existing domestic interexchange market is, as the Commission's longstanding definition provides, a single nationwide market encompassing all interexchange telecommunications services. Therefore, the Commission should make no changes in the geographic and product market definitions adopted in the Competitive Carrier proceeding for purposes of analyzing competition in the existing interexchange services market.

Structural Separation. The comments -- especially those of the state regulators -- confirm that the BOCs and independent

LECs have the ability and incentive to leverage their local exchange monopolies to improperly advantage their out-of-region interexchange businesses in many ways, including cost-shifting, the sharing of confidential marketing information received from interexchange carriers, and the use of monopoly power to induce in-region customers to purchase their out-of-region services. This continuing reality warrants not only the existing separation safeguards imposed on independent LECs, but also full structural separation to reduce the risk of anticompetitive conduct. At a minimum, the Commission should prohibit joint marketing and the sharing of confidential information between a LEC and its interexchange affiliate. Contrary to the BOCs' claims, the 1996 Act does not prohibit the Commission from imposing these reasonable separation safeguards.

Rate Averaging. Consistent with the legislative history of Section 254(g) and the overall procompetitive policy of the 1996 Act, the Commission should continue to implement its rate averaging policies in a balanced and flexible manner that accommodates the needs of effective competition. In particular, the Commission should make clear that:

(1) Interexchange carriers may continue to assess surcharges to recover state-specific costs arising from state gross receipts taxes;

(2) Interexchange carriers may continue to offer regional promotions, point-to-point private line rates, and Tariff 12, contract tariff and other high end business services in the manner they are provided today;

(3) Interexchange carriers may continue to respond to the needs of customers in particular areas or regions by taking any pricing action justified by competitive necessity; and

(4) State rules for intrastate rate averaging are preempted to the extent that they are not narrowly focused, distort competition, or otherwise are inconsistent with the rules for interstate rate averaging.

Furthermore, the Commission should forbear from applying geographic rate averaging requirements to the services of nondominant carriers. At most, if the Commission deems it appropriate, it could require all interexchange carriers to file a schedule of nationwide averaged basic rates available to all residential customers.

Finally, because the competitive pressure to deaverage rates is to a large extent a product of the current high level of access charges imposed on interexchange carriers, the Commission should move quickly to overhaul the existing access charge mechanism to remove subsidies and to price access services at efficient, forward-looking cost-based levels. The Commission should defer the implementation of any rate averaging requirements until such access reform is complete.

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REPLY COMMENTS OF AT&T CORP.

Pursuant to Section 1.415 of the Commission's Rules and its Notice of Proposed Rulemaking, released March 25, 1996 ("NPRM"), AT&T Corp. ("AT&T") submits these reply comments on the issues of (1) market definition for interexchange services, (2) separation safeguards for local exchange carrier ("LEC") out-of-region interstate, interexchange services, and (3) the rate averaging and rate integration requirements of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) ("1996 Act").[1]

[1] The parties filing comments in this first phase of the proceeding are listed on Attachment A. Insofar as those comments address issues that are to be addressed in the second phase of the proceeding, AT&T will discuss those issues in its reply comments in the second phase, to be filed on May 24, 1996.

I. THE COMMISSION'S LONGSTANDING DEFINITION OF THE SINGLE NATIONWIDE MARKET FOR ALL DOMESTIC, INTEREXCHANGE TELECOMMUNICATIONS SERVICES REMAINS CORRECT AND SHOULD NOT NOW BE MODIFIED, BUT THE COMMISSION WILL NEED TO DEFINE AND ANALYZE THE BOCS' LOCAL MARKETS IN ORDER PROPERLY TO ASSESS ANY BOC APPLICATIONS UNDER SECTION 271.

The NPRM proposes to modify the Commission's longstanding definition of a single national market for all domestic interexchange services for two reasons. First, the NPRM suggests (¶ 40) that a more narrow geographic definition might be useful in evaluating Bell Operating Company ("BOC") applications under Section 271 of the 1996 Act to provide interLATA services in regions in which they control local bottleneck monopolies. Second, it suggests (id.) that more narrowly defined markets may assist in analyzing the competitiveness of specific services offered by interexchange carriers today.

As AT&T showed, and the overwhelming majority of other parties' comments confirm, neither rationale supports any modification of the Commission's existing interexchange market definition. First, while the Commission assuredly will need to examine regional market conditions in assessing any BOC applications under Section 271, the relevant inquiry must focus on the local markets for exchange and exchange access services where the BOCs have bottleneck monopolies, not the interexchange market from which they have been excluded. Second, the Commission's existing definition of the interexchange market is correct, and provides a currently suitable framework for analyzing issues of competition and market power.

A. The Proper Focus In Reviewing Any Future BOC Application To Provide In-Region InterLATA Services Under Section 271 Will Be On Whether The BOC Continues To Have Bottleneck Control In Its Local Markets.

Except for the BOCs, the comments agree with the Commission that the existing interexchange market definition will not be useful to the Commission's review of any future BOC Section 271 applications to provide in-region interLATA services.[2] However, contrary to the proposal in the NPRM for a narrowing of the interexchange services market, the comments show that the proper focus for Commission review of such applications will be the local markets for exchange and exchange access services, and whether the BOCs have lost their bottleneck control in those markets.[3]

The current definition of the nationwide interexchange market will have no relevance to BOC applications under Section 271, because the BOCs have always been excluded from this market, first by the MFJ and now by Section 271. Accordingly, their share of the interexchange services market will be near zero regardless of how that market is defined. This does not mean that they have no market power, however, and the BOCs' assertion that they lack market power over interexchange services because they have no market share[4] is both disingenuous and incorrect as a matter of law.

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[2] See AT&T, pp. 6-12; CompTel, p. 4; Frontier, pp. 3-6; GSA, p. 2; LDDS WorldCom, p. 6; MCI, p. 7; TRA, pp. 7-12; Vanguard, pp. 8-11.

[3] See AT&T, pp. 6-12; GSA, p. 2; Vanguard, pp. 9-11; CompTel, p. 4; Frontier, pp. 3-6; MCI, p. 7; TRA, pp. 7-12.

[4] See Ameritech, p. 5; BellSouth, p. 17; Pacific, p. 8; US West, p. 7.

The BOCs' market power over interexchange services is a product of the BOCs' local bottleneck monopolies. These bottlenecks give them the unique power to impede interexchange competition by leveraging their control over essential exchange and exchange access facilities to disadvantage unaffiliated interexchange carriers. These bottlenecks -- and the incentive the BOCs would have to abuse them if they were allowed to compete in the interexchange market -- were the express reason why the MFJ prohibited the BOCs from providing interexchange services until they could establish that they no longer had bottleneck monopolies.[5]

Section 271 of the 1996 Act codifies that principle by prohibiting any BOC from providing in-region interexchange service in any state until the Commission determines that (1) the BOC has taken prescribed steps to open its local market in that state to competition, (2) the BOC faces facilities-based competition in the provision of exchange services to business and residential customers, and (3) the BOC's proposed entry into the interexchange market would serve the public interest.[6] Thus, the issue in any future Section 271 proceeding will not be whether the BOC has a monopoly share of the interexchange market, but whether the BOC has lost its market power in its local markets for exchange and exchange access services so that it can no longer disadvantage competing interexchange carriers. To the extent a more refined

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[5] See United States v. Western Elec. Co., 552 F. Supp. 131, 231 (D.D.C. 1982) (Section VIII(C)).

[6] See 47 U.S.C. § 271(d)(3).

market definition is necessary, therefore, it should relate to those local markets.[7]

In all events, the definition of today's interexchange services market will be irrelevant to that inquiry. As many of the comments recognize,[8] any BOC in-region entry into the interexchange services market (which will be preceded by the entry of interexchange carriers into local markets) would likely break down today's separate markets for local and interexchange services and create new markets comprised of all telecommunications services offered to residential or business customers in particular regions or metropolitan areas. For the present, however, the record provides no basis for changing the Commission's existing interexchange market definition in order to deal with future BOC Section 271 applications.

B. The Commission's Single National Market Definition For Domestic Interexchange Services Should Not Now Be Modified.

The comments overwhelmingly agree that the existing market for domestic interexchange telecommunications services is a single nationwide market that encompasses all interexchange telecommunications services.[9] Accordingly, the comments establish

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[7] The Commission has already solicited and received comments on the appropriate market definition for exchange access services in CC Docket No. 94-1.

[8] See, e.g., AT&T, pp. 5, 13; US West, p. 3; LDDS WorldCom, p. 5.

[9] See Ameritech, p. 13; Bell Atlantic, p. 5; BellSouth, p. 10; NYNEX, p. 4; Pacific, p. 4; SBC, p. 2; US West, p. 2; AT&T, p. 14; MCI, pp. 4, 6; LDDS WorldCom, pp. 4-5; Sprint, p. 4; GSA, p. 2; USTA, p. 13; Florida PSC, p. 8.

that no changes are needed in the geographic and product market definitions adopted in the Competitive Carrier proceeding to analyze competition in the existing interexchange services market.[10]

Virtually all of the comments agree that there is today a single, nationwide geographic market.[11] As the Commission itself has repeatedly recognized, buyers ordinarily buy, and virtually all sellers sell, "ubiquitous calling" which enables callers to place calls to anywhere in the country.[12] Moreover, the principal facilities-based interexchange carriers all have nationwide networks with alternative geographic routing capabilities, and new carriers can and do enter additional areas either by constructing new facilities or by interconnecting and reselling the services of other carriers.[13] Both demand and supply substitutability, therefore, strongly support a nationwide geographic market for interexchange telecommunications services. By contrast, no commenting party supports the NPRM's proposed "point-to-point"

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[10] See Fourth Report and Order, Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, 95 F.C.C.2d 554, 563-64, 574-75 (1983) ("Fourth Report and Order"), vacated on other grounds, AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992). See also Order, Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 1995 FCC LEXIS 6877, at *6 (¶ 7) (FCC Oct. 23, 1995) ("AT&T Nondominance Order").

[11] See Ameritech, p. 13; Bell Atlantic, p. 5; BellSouth, p. 10; NYNEX, p. 4; Pacific, p. 4; SBC, p. 2; US West, p. 2; AT&T, p. 18; MCI, pp. 4, 6; LDDS WorldCom, pp. 4-5; Sprint, p. 4; GSA, p. 2; USTA, p. 13; Florida PSC, p. 8.

[12] NPRM, ¶¶ 50-51; Fourth Report and Order, 95 F.C.C.2d at 574. See also Bell Atlantic, p. 6; AT&T, p. 19.

[13] Fourth Report and Order, 95 F.C.C.2d at 573-74. See also BellSouth, p. 17; AT&T, pp. 19-20.

approach to the geographic market[14] -- an approach which the Commission itself has repeatedly rejected in the past.[15]

The comments also overwhelmingly agree that all interexchange telecommunications services are today in the same relevant product market.[16] This conclusion follows from the fact that there is substantial substitutability by both buyers and sellers among different interexchange services. Buyers can and do substitute private line for switched services, or analog for digital services, in response to price differences.[17] More importantly, however, it is undisputed that there is no significant difference between the facilities used to provide different interexchange services.[18] Thus, numerous interexchange suppliers

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[14] See, e.g., AT&T, pp. 20-21; BellSouth, pp. 11-12; Pacific, p. 6; Florida PSC, p. 8. Even GCI, the only party supporting the idea of a less than national market, specifically rejects the Commission's proposed point-to-point approach to the geographic market as "not adequate." GCI, p. 2.

[15] See, e.g., Fourth Report and Order, 95 F.C.C.2d at 573-74 (the capacity of interexchange carriers' networks "cannot be segmented into distinct city pairs or even domestic regions"); Memorandum Opinion and Order, Application of MCI Communications Corp. & S. Pac. Telecommunications Corp. for Consent to Transfer Control of Qwest Communications, Inc., 10 FCC Rcd. 1072, 1075 (1994) ("it would be inaccurate to segment the market into distinct city pairs or even domestic regions. . . . because many networks have alternative routing capabilities with nationwide or near nationwide service areas").

[16] See Ameritech, p. 13; Bell Atlantic, p. 5; BellSouth, p. 10; NYNEX, p. 4; Pacific, p. 4; SBC, p. 2; US West, p. 2; AT&T, pp. 15-16; MCI, pp. 4, 6; LDDS WorldCom, pp. 4-5; Sprint, p. 4; GSA, p. 2; USTA, p. 13.

[17] See, e.g., Fourth Report and Order, 95 F.C.C.2d at 564-66.

[18] See AT&T Nondominance Order, ¶ 23; Memorandum Opinion and Order, Application of MCI Communications Corp. & S. Pac. Telecommunications Corp. for Consent to Transfer Control of Qwest Communica-

(continued...)

could use existing interexchange facilities to divert customers away from any carrier that lacks market power and is foolish enough to try to charge anticompetitive rates for any interexchange service.

The comments further establish that the Commission's proposal to define narrower relevant product markets based solely on demand substitutability and without regard to supply substitutability would be contrary to all relevant authority and produce clearly erroneous results.[19] Contrary to the Commission's proposed approach, the Justice Department's Merger Guidelines expressly recognize that where "production substitution among a group of products is nearly universal among the firms selling one or more of those products, . . . an aggregate description of those markets" is appropriate.[20] Moreover, even where supply substitutability is not sufficiently pervasive to define the relevant market, the Guidelines require consideration of supply substitution to identify the firms that participate in the relevant market and to analyze the possibility of entry. Id. at 20,571. Thus, in cases where, as here, there is substantial supply substitutability,

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[18] (...continued)
tions, Inc., 10 FCC Rcd. at 1075 ("telecommunications transmission media . . . generally can be adjusted readily to provide virtually any interexchange telecommunication service efficiently"); Fourth Report and Order, 95 F.C.C.2d at 565 ("facilities readily can be switched among voice, data, facsimile, and video services, private line and switched services, and point-to-point and point-to-multipoint services").

[19] See AT&T, pp. 16-18; MCI, pp. 5-6 n.7.

[20] 1992 U.S. Department of Justice/Federal Trade Commission Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 at 20,573-4 n.14.

the Guidelines include not only the sales of all firms that currently sell in the market, but also the sales of firms that would likely enter the market within one year in response to "'a small but significant and nontransitory' price increase." Id. at 20,573-3 (§ 1.32). The Guidelines, therefore, strongly support a relevant product market that includes all interexchange services.

Finally, the Commission should reject SNET's argument that AT&T's 800 directory assistance service constitutes a separate service market, because, according to SNET, there is no close substitute for the service.[21] As the Commission recently recognized in its AT&T Nondominance Order, even though AT&T is presently the sole supplier of this service, the same supply substitutability that constrains carriers' pricing of other interexchange services precludes any "significant danger that AT&T [would] raise substantially the price of this service to the detriment of consumers."[22] SNET has presented no facts that would support a contrary conclusion in this proceeding.[23]

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[21] SNET, pp. 19-20.

[22] AT&T Nondominance Order, ¶¶ 102-03.

[23] See also BellSouth, p. 13 ("Without specific evidence regarding [800 directory assistance], the market cannot be defined. This is not the appropriate proceeding in which to conduct an examination of whether separately identifiable product markets exist on the fringe of the telecommunications market").

II. THE COMMISSION SHOULD IMPOSE ADDITIONAL SEPARATION SAFEGUARDS ON THE LECS' OUT-OF-REGION INTEREXCHANGE SERVICES TO REDUCE THE RISK OF COST-SHIFTING AND OTHER ANTICOMPETITIVE CONDUCT.

Except for the LECs' predictable opposition, virtually all commenting parties agree that separation safeguards are vital to protect against cross-subsidization and other anticompetitive conduct by LECs that provide out-of-region interexchange services.[24] The Commission itself very recently recognized the need for structural separation safeguards on a BOC seeking nondominant treatment for its out-of-region interexchange services in order to "prevent a BOC from gaining any unfair competitive advantage, either through unreasonably discriminatory practices or cross-subsidization, that could arise because of its ownership and control of local exchange facilities."[25]

The comments here, as well as the record in the Out-of-Region proceeding, make clear that the BOCs and independent LECs have both the ability and the incentive to leverage their local exchange bottlenecks to improperly advantage their out-of-region

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[24] See ACTA, p. 7; Alabama PSC, pp. 5-7; CWI, pp. 7-8; CompTel, pp. 3-5; GSA, pp. 3-4; GCI, pp. 4-6; LDDS WorldCom, pp. 7-11; MCI, pp. 11-26; MFS, pp. 7-8; Missouri PSC, p. 4; Sprint, pp. 7-9; Ohio PUC, pp. 2-4; TRA, pp.7-26; Vanguard, pp. 3-11; Washington UTC, pp. 1-3.

[25] See Notice of Proposed Rulemaking, Bell Operating Co. Provision of Out-of-Region Interstate, Interexchange Services ("Out-of-Region proceeding"), CC Docket No. 96-21, ¶ 7 (February 14, 1996). The three modest structural safeguards proposed by the Commission in the Out-of-Region proceeding call for the BOC and its interexchange affiliate to: (1) maintain separate books of account; (2) not jointly own transmission or switching facilities with the BOC local exchange company; and (3) obtain any BOC exchange telephone company services at tariffed rates and conditions. Id. at ¶ 13. These safeguards have been applied to independent LECs that provide interexchange service.

interexchange affiliates.[26] That prospect justifies strict structural separation between a LEC and an interexchange service affiliate for which it seeks nondominant status. At the very minimum, the Commission must not weaken the separation safeguards it proposed for the BOCs in the Out-of-Region proceeding. Rather, as AT&T and several parties show, separation safeguards should be strengthened at the prospect of BOC provision of out-of-region interexchange services.[27]

The need for strict structural separation is clearly established by the comments of the state regulators, who are the people with the most experience in dealing with these issues and the problems of regulating the LECs' conduct. Their comments specifically assert the need for strict separation safeguards to reduce the potential for cost-shifting and other abuses of the LECs' monopoly power. As the Public Utility Commission of Ohio ("PUCO") explains:

> [T]he PUCO believes that modification or elimination of the separation requirements as they apply to LEC interexchange affiliates would result in cost-shifting and possible anticompetitive behavior. The PUCO's experience over the last ten years of regulating BOC and other telephone company

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[26] See, e.g., LDDS WorldCom, p. 10 ("Given the paramount fact of overwhelming RBOC market power, and the lack of any meaningful competition in the local exchange market now and in the immediate future, the RBOCs have every ability and incentive to leverage their market power into discriminatory conduct against their new rivals in the long distance market"); TRA, p. 13 ("LECs are in a position to leverage their 'bottleneck' power to disadvantage competing providers of long distance telecommunication services"); GSA, p. 3; Vanguard, p. 9; MCI, pp. 13-14.

[27] See AT&T, pp. 26-27; LDDS WorldCom, pp. 10-11; CompTel, pp. 3-5; TRA, pp. 19-24.

> affiliates has revealed that to achieve true separation between the LEC and its affiliate, it has been necessary to order progressively more specific separation requirements.[28]

Other state commissions reach the same conclusion.[29]

The overriding reality is that both the BOCs and the independent LECs have a significant ability to use their in-region monopolies to obtain wrongful advantages with respect to interexchange calls that originate outside their regions. For example, they can (1) price terminating access in ways that cross-subsidize their interexchange affiliates or effect a price squeeze on competitors;[30] (2) misuse the confidential marketing plans and information about future access needs that interexchange competitors must disclose to Bellcore and individual LECs;[31] and (3) engage in other kinds of monopoly abuses including improper joint marketing to induce in-region customers to purchase out-of-region services.[32]

For these reasons, the Commission should consider imposing the full structural separation safeguards of the Second

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[28] Ohio PUC, pp. 2-3.

[29] See Alabama PSC, p. 7 ("The separations vehicle provides a stronger assurance of protection against cross-subsidization"); Washington UTC, p. 2 ("to eliminate the separation requirements prematurely could lead to anti-competitive and discriminatory pricing in the market"); Missouri PSC, p. 4.

[30] See AT&T, pp. 10-11, 24-25; MCI, pp. 13-14, 17; TRA, pp. 14-15; Fifth Report and Order, Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, 98 F.C.C.2d 1191, 1204 (1984) ("Fifth Report and Order").

[31] See AT&T, p. 25; GSA, p. 3; MCI, p. 18.

[32] See AT&T, pp. 25-26; GSA, p. 3; Vanguard, pp. 9-10.

Computer Inquiry on LECs that seek nondominant status for their provision of out-of-region interexchange services. At the very least, however, the Commission should require that the BOCs and independent LECs may not engage in any (1) joint marketing or (2) sharing of information between their monopoly in-region companies and their interexchange affiliates.[33]

Predictably, many of the LECs and some of their affiliated trade associations argue that structural separation safeguards are unnecessary. First, they argue that Section 271(b)(2) of the 1996 Act "explicitly does not require" separate subsidiaries for the provision of out-of-region interexchange services and that any such requirement is therefore forbidden.[34] This is simply wrong. Next, they argue that separation safeguards are unnecessary because the LECs have no market power and are thus nondominant in the market for interexchange services.[35] This claim ignores the LECs' enormous bottleneck power over an essential input in the interexchange market. Finally, they assert that existing regulation is sufficient to deter any potential for the monopoly abuses the Commission has identified.[36]

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[33] See AT&T Comments, Out-of-Region proceeding (filed March 13, 1996); AT&T Reply Comments, Out-of-Region proceeding (filed March 25, 1996).

[34] See BellSouth, pp. 24-25; NYNEX, p. 9; Ameritech, pp. 10-11; Bell Atlantic, p. 3; US West, p. 10.

[35] See Ameritech, pp. 3-10; US West, p. 11; Bell Atlantic, p. 3; NYNEX, pp. 11-12; GTE, pp. 7-8; SBC, p. 8; USTA, p. 8.

[36] See BellSouth, p. 24; SNET, pp. 9-12; NYNEX, p. 13; GTE, pp. 10-11; Bell Atlantic, p. 4; SBC, pp. 6-7; USTA, pp. 8-9.

As to the LECs' first claim, the 1996 Act does not prohibit the Commission from imposing reasonable safeguards on a BOC that wishes to benefit from nondominant regulation for its provision of out-of-region interexchange services.[37] Section 271(b)(2) does not address the Commission's separation safeguards at all, and Section 272(a)(2) merely provides that the fully separate subsidiary requirements that must be applied to a BOC's in-region interexchange services do not automatically apply to out-of-region services.[38] Nothing in the 1996 Act suggests that the Commission should alter its longstanding rules imposing dominant carrier status on a company with market power or one controlling an essential facility.[39] BOC affiliates may immediately enter any out-of-region area and provide interexchange service, but they do so as dominant carriers because of their bottleneck control over

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[37] To the contrary, the 1996 Act expressly preserves the Commission's ability to enforce such reasonable safeguards. See, e.g., 47 U.S.C. §§ 261(a) ("Nothing in this part shall be construed to prohibit the Commission from enforcing regulations prescribed prior to the date of enactment of the [1996 Act] in fulfilling the requirements of this part, to the extent that such regulations are not inconsistent with the provisions of this part"); 272(f)(3) (preserving authority of the Commission "to prescribe safeguards consistent with the public interest, convenience, and necessity").

[38] Even if Section 272 were interpreted to prohibit the Commission from requiring a separate subsidiary for out-of-region interexchange services, the Commission's regulations do not contain such a requirement. The BOCs have the choice of dominant carrier regulation or operation through the specified separation safeguards. Notice of Proposed Rulemaking, Out-of-Region proceeding, ¶ 13.

[39] See Second Computer Inquiry, 77 F.C.C.2d 384 (1980).

essential facilities.[40] Alternatively, they may create a separate subsidiary consistent with the Commission's structural separation rules. These requirements provide at least a modest degree of protection against the BOCs leveraging their indisputable power in local exchange markets into out-of-region interexchange services.

The LECs also cannot credibly deny their market power over interexchange services. As the comments make clear, the LECs' local bottleneck monoplies give them market power over inter-exchange services and the ability to impede competition in the provision of those services -- including the ability improperly to advantage their out-of-region affiliates.[41]

Also contrary to the LECs' claims, existing nonstructural regulations on access services will not adequately protect the public interest. Because LEC access services are both an essential input and a substantial portion of the costs of providing interexchange services, they can, in myriad and subtle ways, be used illicitly to advantage -- or harm -- interexchange carriers. Even the existing requirements for nondominant treatment of LEC interexchange services allow the types of joint activity, common personnel, and sharing of information that provide the opportunity

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[40] See First Report and Order, Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Therefor, 85 F.C.C.2d 1, 21-22 (1980); Fifth Report and Order, 98 F.C.C.2d at 1198-99 & n.23, where the Commission acknowledged that its existing rules provide that BOCs entering the interexchange market would be classified as dominant carriers pending a determination of what separation rules should apply. Because nothing about the BOCs' bottleneck power has changed, dominant carrier status is still appropriate unless significant structural safeguards are imposed.

[41] See AT&T, p. 11; MCI, pp. 13-14; LDDS WorldCom, p. 10; TRA, p. 13; GSA, p. 3; Vanguard, p. 9.

for cost-shifting, discrimination in the pricing and provisioning of access, improper use of information, and other wrongful leveraging of the LECs' local exchange monopolies into the adjacent interexchange market. Indeed, it was only the complete separation requirements of the MFJ and the stringent requirements of the GTE decree that until recently served to protect interexchange competition from the leveraging of the BOC and GTE local exchange monopolies. Now, as the Commission recently recognized in the Out-of-Region proceeding, concerns about the BOCs' "potential cost-shifting and anticompetitive conduct" justify imposing separation safeguards on a BOC wishing nondominant treatment for its out-of-region interexchange services.[42] Many other commenters reach the same conclusion.[43]

The LECs also claim that price cap regulation removes the exchange carriers' ability and incentive to cross-subsidize interexchange service because the carriers cannot raise prices on other services to support underpriced interexchange service.[44] This claim ignores the fact that not all LECs have elected to be regulated under price caps, and even the carriers that are so regulated may periodically elect a "sharing" option which recreates

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[42] Notice of Proposed Rulemaking, Out-of-Region proceeding, ¶ 9 (February 14, 1996).

[43] See Sprint, p. 8 ("The separation requirements . . . are certainly the best, and perhaps the only, reliable tool that the Commission has at hand for this purpose"); GSA, p. 3 ("Only a complete structural separation can ensure against cross-subsidy and abuse of marketing advantages"); MCI, pp. 22-24; Ohio PUC, pp. 2-3; Alabama PSC, p. 7; Washington UTC, p. 2; Missouri PSC, p. 4.

[44] See, e.g., BellSouth, p. 24.

the incentive and opportunity to shift costs. More importantly, price cap regulation does not eliminate incentives for leveraging or address the many other forms of potential monopoly abuse, including those the Commission, AT&T and other commenters have identified, such as overcharges for access termination, the misuse of confidential market information, and improper joint marketing.

Finally, the BOC and LEC complaints about the costs of complying with separation safeguards are meritless. The short answer here is that BOCs and LECs are already beginning to create separate affiliates with no undue burden. For example, on the basis of its "first-hand" experience, Sprint states that separation safeguards are not "unduly burdensome."[45] To the contrary, it states:

> if a LEC or BOC is to deal with its own affiliated IXC entity in a non-discriminatory fashion (that is, if it treats, as it must, such IXC affiliate in exactly the same way as it treats other IXC providers), there is no reason why that LEC or BOC would be hampered, or even seriously inconvenienced, if it continues to be required to [follow the Commission's separation safeguards].[46]

Indeed, the only significant "burden" of these requirements to incumbent LECs is that they limit -- although they do not eliminate

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[45] Sprint, p. 8.

[46] Id. Pacific Telesis contends that it has created a fully separate subsidiary under Section 272 of the 1996 Act. Pacific states that the Commission's separation safeguards should apply to the interLATA affiliates of all LECs, including the BOCs, whether in-region or out-of-region, until the separate affiliate requirement is lifted according to the timetable in the 1996 Act. Pacific, pp. 9-10.

-- the ability of those LECs to engage in the anticompetitive conduct the requirements were designed to prevent.

III. THE RATE AVERAGING PROVISION IN SECTION 254(g) OF THE 1996 ACT SHOULD BE ADMINISTERED IN A MANNER CONSISTENT WITH THE OVERALL PROCOMPETITIVE POLICY OF THE 1996 ACT.

Every interexchange carrier agrees that Section 254(g) of the 1996 Act simply codifies the Commission's existing policy of requiring nationwide geographic rate averaging of basic telecommunications services while permitting more narrowly targeted contract rates and local promotions.[47] In contrast, advocates for some rural states and interest groups contend that Section 254(g) mandates an absolute and inflexible requirement of nationwide rate averaging for all interexchange telecommunications services that categorically prohibits any local or regional price discounts or promotions -- or even local advertising campaigns -- by any national carrier.[48] This extreme view is refuted both by the clear legislative history of Section 254(g) and by the fundamental procompetitive policy of the 1996 Act.[49]

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[47] See AT&T, pp. 31-33; TRA, p. 27 ("it is apparent from the legislative history of the '96 Act that the Congress intended to codify the manner in which the Commission has incorporated geographic rate averaging and rate integration into its current regulatory regime"); CompTel, p. 6 ("Congress intended the rate averaging and integration provisions of the 1996 Act to codify existing FCC policies"); MCI, p. 26; Sprint, p. 14; LDDS WorldCom, p. 13; CWI, pp. 3-4; Frontier, p. 9; ACTA, pp. 8-10; GCI, pp. 6-7.

[48] See, e.g., RTC, pp. 13-14; USTA, p. 3; TDS, p. 4; TCA, p. 4; Staurulakis, pp. 4-5; Alabama PSC, p. 8; Alaska, pp. 3, 7; Hawaii, p. 7; Ohio Consumers' Counsel, p. 5.

[49] Section 254(g) is directed exclusively to carrier "rates" and provides no statutory basis at all for the Commission to regulate carriers' advertising practices. See also Pacific, pp. 12-13 (continued...)

As the conference report for the bill clearly states, Section 254(g) "is intended to incorporate the [Commission's] policies of rate averaging and rate integration."[50] Furthermore, the conference report makes clear that Congress was well aware that the Commission "has permitted interexchange providers to offer non-averaged rates for specific services in limited circumstances" and that Congress intends that the Commission, where appropriate, should continue to authorize exceptions using its forbearance authority under Section 10 (id.). Similarly, the report on the Senate bill states that Section 254(g) "simply incorporates in the Communications Act the existing practice of geographic rate averaging and rate integration for interexchange, or long distance, telecommunications rates."[51] The legislative history of Section 254(g), therefore, makes perfectly clear that Congress intended no change in the Commission's existing flexible rate averaging policies.

Moreover, the comments demonstrate that any contrary interpretation would put Section 254(g) in direct conflict with the

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[49] (...continued)
("Section 254(g) . . . does not contemplate regulating the conduct of [carriers'] advertising campaigns," and the Commission should not put itself in the position of "second-guessing carriers' marketing and advertising judgments").

[50] H.R. Rep. No. 458, Joint Explanatory Statement of the Comm. of Conference, 104th Cong., 2d Sess. 132 (1996) ("Joint Explanatory Statement").

[51] Joint Explanatory Statement at 129 (emphasis added). As the NPRM (¶ 68 n.153) points out, Section 254(g) contains only minor modifications from the geographic rate averaging provision of the Senate bill.

overall procompetitive policy of the 1996 Act.[52] As the NPRM recognizes, the 1996 Act seeks "to provide for a pro-competitive, de-regulatory national policy framework . . . by opening all telecommunications markets to competition" (NPRM, ¶ 1). Yet effective interexchange competition would be severely curtailed or precluded if the Commission were to implement Section 254(g) by imposing a rigid rate averaging requirement on all interexchange rates and services.

Until now, AT&T and other national interexchange carriers have generally offered service throughout the country using nationwide averaged rates. At the same time, however, the Commission has authorized such carriers to provide a wide variety of more narrowly focused private line, contract tariff and other high end business offerings, regional promotions, and local surcharges to recover state-specific gross receipts taxes.

As large LECs enter selected high volume, low cost portions of the market on a regional basis, national carriers -- which serve both low and high cost areas -- must continue to have the flexibility to respond to competition with rates that reflect their actual costs. Such flexibility will increase competition and benefit consumers by producing lower prices and more choices. Absent such flexibility, national carriers will be severely disadvantaged and will ultimately be forced to choose between abandoning the low cost areas to the regional carriers and charging higher rates to their remaining rural and high cost customers, or

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[52] See AT&T, pp. 28-31; MCI, pp. 29-31; Sprint, pp. 11-17; TRA, pp. 27-30; ACTA, pp. 8-10; CWI, pp. 4-5 & n.8; Florida PSC, pp. 13-14.